

## Independent Auditor's Report

To the Inspector General of the  
Department of Health and Human Services and  
the Administration for Children and Families

We have audited the accompanying consolidated balance sheets of the Administration for Children and Families (ACF), an operating division of the Department of Health and Human Services (HHS), as of September 30, 2002 and 2001, the related consolidated statements of net cost for the years then ended; and the related consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002 (collectively the Financial Statements). These financial statements are the responsibility of ACF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the Financial Statements present fairly, in all material respects, the financial position of ACF at September 30, 2002 and 2001, its net cost for the years then ended; and its changes in net position; budgetary resources; and reconciliation of net cost to budgetary resources for the year ended September 30, 2002 in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our reports dated December 9, 2002 on our consideration of ACF's internal control over financial reporting, and on our tests of ACF's compliance with certain provisions of laws and regulations. Those reports are an integral part of our audits performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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Our audits were made for the purpose of forming an opinion on the basic Financial Statements taken as a whole. The Supplemental Information, described in the Table of Contents on page 16, is not a required part of the basic Financial Statements. Such information is supplementary information required by OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and the Financial Accounting Standards Advisory Board. The Other Accompanying Information is presented for the purposes of additional analysis and is not a required part of the basic Financial Statements. We have applied certain limited procedures, which consisted principally of inquiries of ACF management regarding the methods of measurement and presentation used for this Supplementary Information and comparing this information for consistency with that reflected in the basic Financial Statements, as applicable. However, we did not audit the information and express no opinion on it.

*Clifton Gundersen LLP*

Calverton, Maryland  
December 9, 2002

## Independent Auditor's Report on Compliance with Laws and Regulations

To the Inspector General of the  
Department of Health and Human Services and  
the Administration for Children and Families

We have audited the Financial Statements of the Administration for Children and Families (ACF), an operating division of the Department of Health and Human Services (HHS), as of and for the year ended September 30, 2002 and have issued our report thereon dated December 9, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The management of ACF is responsible for complying with laws and regulations applicable to ACF. As part of obtaining reasonable assurance about whether ACF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material affect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to ACF.

The results of our tests of compliance with laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether ACF's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed no instances in which ACF's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of ACF, HHS, the HHS Office of the Inspector General, OMB and Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

*Clifton Henderson LLP*

Calverton, Maryland  
December 9, 2002

## Independent Auditor's Report on Internal Control

To the Inspector General of the  
Department of Health and Human Services and  
the Administration for Children and Families

We have audited the Financial Statements of the Administration for Children and Families (ACF), an operating division of the Department of Health and Human Services, as of and for the year ended September 30, 2002, and have issued our report thereon dated December 9, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to the financial audits contained in *Government Auditing Standards*; issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered ACF's internal control over financial reporting by obtaining an understanding of ACF's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act (31 U.S.C. 3512), such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the ACF's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted certain matters discussed in the following section involving the internal control and its operation that we consider to be reportable conditions. However, none of the reportable conditions is believed to be a material weakness.

In addition, we considered ACF's internal control over Required Supplementary Stewardship Information by obtaining an understanding of ACF's internal control, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 01-02, and not to provide assurance on these internal controls. Accordingly, we do not provide assurance on such controls.

Finally, with respect to internal controls related to performance measures reported in ACF's Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

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We have noted improvement in ACF's internal control system since last year, and some of the matters noted in our prior report have been resolved. However, certain matters raised in our prior year report continue to need improvement. We have described the reportable conditions below.

HHS's Assistant Secretary for Budget, Technology, and Finance (ASBTF) office provides the Department-wide accounting policy oversight to ACF. The Division of Financial Operations (DFO) of the Program Support Center (PSC) provides the accounting and fiscal services to ACF, including the preparation of annual financial statements. The Division of Payment Management (DPM) of the Program Support Center (PSC) provides grant accounting services to ACF, including grant disbursement, expenditure, and advance processing functions. Accordingly, DFO and DPM are considered part of the ACF's management and is responsible for carrying out many of the accounting procedures on behalf of ACF.

## **REPORTABLE CONDITIONS**

### **1. PREPARATION AND ANALYSIS OF FINANCIAL STATEMENTS**

**Condition:** Pursuant to OMB directives, beginning in fiscal year 2003, quarterly financial statements are required to be submitted to OMB within 45 days of the period end. In addition, beginning in fiscal year 2004, an Agency must obtain an audit of its September 30<sup>th</sup> financial statements by November 15<sup>th</sup>. The Department is contemplating earlier implementation of the new year-end requirement for fiscal 2003.

Even though ACF has made improvements in its financial statement preparation process, and was able to prepare an initial draft of its financial statements for the year ended September 30, 2002 by November 8, 2002, there were two adjustments that significantly impacted certain line items in its initial draft statements. The audit of ACF's financial statements was completed within the time frame prescribed by the Department.

The two most significant transactions described below were both complicated and unusual transactions (i.e. the transactions related to unusual provisions or amendments to existing

laws), and management was aware that further analysis was needed. However, they were unable to complete the final stage of the review process (FACTS II) prior to submitting the initial draft to us on November 8<sup>th</sup> (which was a week earlier than initially planned to allow for the early commencement of the audit). We realized that this was a draft and that management was still in the process of completing its analysis. Even though the matters noted below do not appear to be systemic problems in preparing accurate financial statements, we believe that ACF needs to continue to fine tune its financial statement preparation process and improve on both the performance and the timeliness of the internal review process, to assure compliance with OMB reporting requirements for fiscal 2004.

***The following matters serve to support this conclusion:***

- **Financial Statement Preparation and Analysis Can Be Improved** – ACF's process for preparing the annual financial statements in the Core Accounting System (CORE) continues to be manually intensive and provides for limited resources being available for financial analysis and related research of unusual account relationships. It includes downloading necessary data from CORE, and using microcomputer software to process adjusting entries and to prepare annual financial statements.

An essential part of the preparation of financial statements is the analytical review of such statements once compiled from the accounting records (CORE). Given the difficulties ACF has had in getting information from other Federal agencies (i.e. Treasury) to complete the processing of transactions that need to be reported in its financial statements, and the condensed time frames by which ACF's financial statements must be prepared, there is not much time to analyze the results of the compilation with existing staff. ACF has improved its financial analysis of its Net Cost statement during fiscal 2002; however, improvement is needed in the analysis of its other statements to improve on the overall timeliness of preparing a complete set of accurate financial statements. An important part of this analysis is the comparison of amounts reported via FACTS II transmission (performed by a group different than that preparing the financial statements for audit) with amounts reflected in its financial statements. This analysis could not be done prior to providing us with the first draft of its financial statements on November 8, 2002 because the FACTS II was not completed until the last date allowed by Treasury of November 9, 2002 (due date range was October 25<sup>th</sup> to November 9<sup>th</sup>).

As indicated above, the fiscal 2002 audit was completed within the time frame prescribed by the Department. However, significant changes were necessary to ACF's initial draft of the financial statements provided to us on November 8, 2002. Such changes resulted in reductions to Total Budgetary Recourses by \$4.8 billion. This reduction was principally comprised of two unusual items described as follows:

- a) An adjustment for \$2.83 billion (that also affected Fund Balance with Treasury and is described later in this report) that was identified by management comparing the amounts reflected in the FACTS II transmission to comparable amounts reflected in the general ledger, and an adjustment was

made by management and reflected in the financial statements that were provided to us prior to the completion of the audit. The 4<sup>th</sup> bullet of this finding (regarding FBWT) explains why this difference occurred.

- b) An adjustment for approximately \$1.95 billion relating to an error in the presentation of transferred authority as a cancelled appropriation. This was the result of the accounting treatment needed for an amendment in FY 2002 of a prior year (1997) appropriation. Reconciling the beginning unobligated balance on the Statement of Budgetary Resources to the prior year ending balance identified a difference that, along with a FACTS II comparison, ultimately resulted in the correction of this error by management during the early stages of the audit. An adjustment was made by management and reflected in the financial statements that were provided to us prior to the completion of the audit.

Since the FACTS II transmission was not submitted to Treasury until a day after the financial statements were due to the auditors, a comparison of FACTS II data to ACF's financial statements did not take place prior to submission of ACF's first draft of its financial statements to the auditors. Once this comparison was done by management, these initial draft errors were resolved.

The need for additional financial analysis, and better coordination between all accounting groups, is critical to reduce the likelihood of errors in the statements to be submitted to OMB in future periods. This analysis should not be limited to the three primary statements (Balance Sheet, Net Cost, and Statement of Changes in Net Position); but should also be applied to the Statement of Budgetary Resources and the Statement of Financing, as well as the notes supporting all of its financial statements.

Other errors noted in the initial draft of ACF's financial statements included the following:

- Appropriations Received on the Statement of Budgetary Resources did not agree to same line item on the Statement of Changes in Net Position, a difference of \$280 million.
- Appropriations Used in the two different columns (Cumulative Results and the Unexpended Appropriations) on the Statement of Changes in Net position did not agree by approximately \$3 million.
- Undelivered orders for the current and prior year did not agree to the audited trial balance or within the statements and disclosures. (Difference ranged from \$100 million to \$300 million).
- Net Outlays on the Statement of Budgetary Recourses was different than that reported by Treasury; however, the nature and extent of the difference was not adequately researched prior to the commencement of the audit.
- Trading partner information did not agree with certain amounts reflected in the basic financial statements.



- Balancing entries (ranging from \$20 million to \$100 million) were made to amounts reflected in the Statement of Budgetary Resources and the Statement of Financing.

The correction of these errors also impacted the amounts reflected in the consolidating statements, reported as supplemental information to the basic financial statements.

• **Review and Analysis of Budgetary and Net Position Accounts Needs Improvement**

As indicated earlier in this report, ACF had difficulty in finalizing its Statement of Budgetary Resources (SBR) at September 30, 2002. Even though management was still evaluating certain unusual transactions, the FY 2002 statements initially provided to us on November 8, 2002 (which was a week earlier than initially planned to allow for the early commencement of the audit), contained several errors relating to two transactions that were ultimately resolved by management during the audit. These two errors resulted in adjustments to several line items as follows:

	Initial Draft (000)	Final Draft (000)	Budgetary Resources Increase (Decrease) (000)
Unobligated Balances – Beginning of Period			
Beginning of Period	\$ 7,074,262	\$ 4,240,380	\$ (2,833,882)
Net transfers, actual	-	\$(1,957,898)	\$ (1,957,898)
Temporarily not available pursuant to Public Law	\$ (602,784)	\$(2,559,682)	\$ (1,956,898)
Permanently not available	\$(1,981,878)	\$ (158,263)	\$ 1,823,615
Changes to other line items	\$ 271,129	\$ 347,676	\$ <u>76,547</u>
Net Decrease to Budgetary Resources			\$ <u><u>(4,848,516)</u></u>

The \$2.8 billion correction also impacted the “Other Adjustments” line item initially reflected in the FY 2002 draft Statement of Changes in Net Position provided to us on November 8, 2002.

ACF also continued to record a significant number of miscellaneous adjustments in various net position accounts during and at the end of the year. These adjustments made the reconciliation of these accounts to amounts reflected in the Budgetary Statement difficult and time consuming to perform for September 30, 2002. These miscellaneous adjustments record both the impact of prior year adjusting journal entries and adjustments needed to reconcile other accounts at year-end.

ACF still has not completed periodic reconciliations of Appropriated Capital Used and Expended Authority accounts, as required by HHS Departmental policy. These reconciliations could provide valuable insight into the reasonableness of amounts reflected on the Budgetary and Net Position statements. The lack of reconciliation between the proprietary and budgetary accounts caused a number of differences throughout the statements. These differences included a \$300 million difference between the audited trial balance for undelivered orders, which was used to reconcile the balance for Fund Balance With Treasury in the proprietary accounts, and the

“Status of the Fund Balance” table presented in the Fund Balance note disclosure supporting ACF’s financial statements.

- **FACTS II Preparation Process Needs To Be Linked To Financial Statement Preparation Process** - The US Treasury requires that cash and budgetary information be reported via the FACTS II system on a quarterly basis. The report should be prepared using the same trial balance used by those preparing the basic financial statements. In comparing amounts reflected in ACF’s fiscal 2002 FACTS II transmission and its September 30, 2002 trial balance of accounts used to prepare its financial statements, we noted differences with an absolute value of \$21 billion relating to the following accounts:
  - Total Actual Resources Collected
  - Undelivered Orders Paid
  - Expended Appropriations Paid

Management may revise its FACTS II data to Treasury in January 2003.

- **Year-end Adjustments to Fund Balance with Treasury (FBWT)** – As referred to in the first bullet of this Condition, ACF’s financial statements were initially prepared using an incorrect legal interpretation to account for a certain cancelled appropriation aggregating \$ 2.83 billion, relating to the Temporary Assistance for Needy Families program. This appears to have occurred because the accounting implications of a peculiar aspect of a law were not adequately discussed between the accounting\budget staff and the staff preparing the financial statements, therefore resulting in an initial misstatement of FBWT at September 30, 2002. These funds were removed from Treasury on November 9, 2002 via the FACTS II transmission but did not get reflected in ACF’s first draft of its financial statements. This change in interpretation reflected on ACF’s revised financial statements provided to us prior to the completion of the audit, which was eventually approved by the Department during the audit, also significantly impacted amounts initially reflected in the draft Statement of Budgetary Resources and Statement of Changes in Net Position.
- **Grant Financial Analysis Needs Improvement** – Grants comprise over ninety-seven percent of ACF’s program costs. Accordingly, understanding how grants transactions are compiled in the general ledger, and ultimately reflected in accrual based financial statements is critical to ACF’s determination that the results reflected in the financial statements are reasonable and consistent with the actual activity of its programs.

Even though improvement was noted in the process in fiscal 2002, especially at September 30<sup>th</sup>, ACF continues to have difficulty in performing a timely analysis of the grant related accounts (advances and costs) reflected in its financial statements during the year and at September 30<sup>th</sup>. Even though ACF’s financial statements were available for analysis by management on November 8, 2002, a complete analysis of fluctuations between fiscal 2002 and 2001 cost amounts was not available until a month later. Programs that provided the biggest challenge to ACF included unusual

fluctuations in TANF (an increase of \$1.2 billion over fiscal 2001), Child Support Enforcement (an increase of 25 % over fiscal 2001), and Low-Income Home Energy Assistance (a decline of 19% over fiscal 2001). ACF ultimately concluded that the fluctuation of costs in various GPRA programs was reasonable, but only after exhaustive research and analysis of those program activities in those fiscal years.

In addition, explanations for differences during the year between the actual SF 272 cost data from the grantees and the accrual entry based on the Regression Model were not available from management.

Finally, even though certain grant transactions (with an absolute value of \$10 billion) were properly classified in the initial draft of the financial statements, they were initially posted in error in the general ledger.

**Recommendation:** The future reporting requirements mandated by OMB are much more demanding than those currently in place. The volume and variety of transactional information that Federal agencies must accumulate complicate the goal of complying with these demands. In addition, the coordination and cooperation needed with and by the Department of Treasury is critical in this process for they have certain important financial information that ACF needs to properly close out its accounting records for the month. Also, ACF must rely on its grantees to assist it in continuing to account for transactions under the accrual basis of accounting by providing ACF with timely reports of expenditures.

Procedures currently in place may not be sufficient to meet the reporting deadlines for the audit of ACF's financial statements at September 30, 2004 (or FY 2003 if the Department arbitrarily initiates the required 2004 timetable in 2003 instead). However, by expanding financial analysis during the year, developing estimation methodologies for certain accounts, and changing the manner by which its financial statements are reviewed during the year and at year-end, ACF can improve the accuracy and timeliness of its financial statement preparation process in the future. We recommend that management consider the following suggestions to accomplish that objective:

- a) Assign a person within DFO, not involved in the detailed preparation of the financial statements, to objectively review the financial statements and note disclosures throughout the year for errors. This person could be responsible for the following duties:
  - Coordinate the communication between DFO's two financial management branches to ensure consistent accounting treatment between financial statements and FACTS II transmissions.
  - Evaluate the reasonableness of all material line items in financial statements. Coordinate the effort to research the reason for unusual amounts and relationships. Develop written explanations of management's basis for concluding that such financial statements are reasonable.

- Evaluate financial statements for compliance with OMB and Departmental form and content requirements.
  - Work with the financial statement preparers for the revision of the affected financial statements and notes prior to submission to OMB or other interested parties.
  - After determining the reasons for these errors, coordinate the updating of internal “desk” procedures to include measures to avoid these type errors in the future. This could reduce the time needed to close the accounting records and prepare the financial statements at September 30<sup>th</sup>.
  - Coordinate communication between DFO, ACF management and program officers to identify events and/or unique provisions of laws that have occurred during the year that affect the recording or presentation of transactions reflected in its financial statements and notes.
- b) Analyze all major accounts, including net position and budgetary accounts, with a special emphasis on comparing proprietary and budgetary account relationships and the related accounting implications. Perform reconciliation of accounts pursuant to Department guidelines.
- c) Utilize the information in the CORE accounting system to prepare the FACTS II transmission and compare results to that reflected in the financial statements. Management should consider revising its FACTS II data to Treasury in January 2003.
- d) Cease posting transactions directly to net position accounts during the year. In addition, net position accounts in the general ledger should be analyzed and reconciled throughout the year to minimize this effort at year-end. We also continue to recommend that all audit and year-end closing adjustments be recorded in the CORE Accounting System to avoid reconciliation problems in net position accounts in future years.
- e) Identify outside sources who historically have been slow in providing data to ACF and develop methodologies for estimating year-end balances for those accounts.
- f) Identify laws with unusual provisions and research the impact at the beginning of the year for such laws that may impact amounts reflected in the financial statements.
- g) Grants:
- Continue to test the reasonableness of the Regression Model (RM) accrual methodology. Analytical procedures should be developed in partnership with DPM to assess the results of this test in light of management’s expectations and knowledge about their grant programs. Historical trend analysis can also assist management in demonstrating the reasonableness and reliability of the accrual developed by the RM.
  - Obtain a complete set of financial statements from DFO on a quarterly basis, compare amounts reflected on the statements to those reflected in prior periods, and determine reasonableness of current period amounts, given management’s

expectations of operating results. ASBTF issued a policy memorandum in November 2001 suggesting various analytical review procedures for use in the grants area. We recommend that ACF immediately implement the provisions of this memorandum and work with the Department to further refine these grant analysis procedures, as appropriate.

- Develop procedures to classify transactions as governmental or non-governmental when they are initially recorded in the accounting system to avoid the time consuming task of making manual adjustments during the financial statement preparation process.

## 2. ELECTRONIC DATA PROCESSING CONTROLS

**Condition:** Our tests of internal controls placed in operation over the preparation of ACF's Financial Statements at September 30, 2002, included a review of controls placed in operation over significant accounting systems supporting ACF's basic accounting system (CORE). These supporting systems, such as the as Grants Administration Tracking and Evaluation System (GATES), are often referred to as "feeder" systems.

OMB Circular A-130, Appendix III, "Security of Federal Automated Information Resources," established a minimum set of controls for federal agencies. Such controls include contingency planning, risk assessments, assigning responsibility for security, security planning, periodic review of security controls, and management authorization of systems to process information.

During our review of ACF's security of its information resources, we noted that the risk assessment of the GATES grant application was outdated and the security plan had not been certified or accredited. We also noted that ACF's capability to respond to a disruption in business operations as a result of a disaster or other long-term emergency was uncertain, as their disaster recovery plan was incomplete.

**Recommendation:**

- a) Perform a risk assessment, and obtain certification and accreditations for the GATES grant application.
- b) Complete development and implementation of a plan to improve continuity controls, including formal measures to address a disruption of business operations.

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## STATUS OF PRIOR YEAR'S REPORTABLE CONDITIONS

As required by *Government Auditing Standards* and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, we have reviewed the status of the ACF's corrective actions with respect to the findings and recommendations from our previous reports on the ACF's internal controls. The following analysis provides our assessment of the progress ACF has made through September 30, 2002 in correcting the Reportable Conditions identified in the fiscal 2001 Internal Control Report.

### **1. Condition – Grant Accounting:**

- *Grant Accrual* – Differences between the grant accrual, based on the Regression Model, and actual costs, were less significant during fiscal 2002. Even though this matter is substantially resolved, continued monitoring of actual versus estimate differences is needed. See Reportable Condition #1 in the current year Internal Control Report.
- *Financial Analysis* – Improvement has been noted, but further refinement is needed. See Reportable Condition #1 in the current year Internal Control Report.
- *Grant Transaction Processing* – The condition relating to intra and non-governmental classification has been repeated in Reportable Condition #1 in current year Internal Control Report. The other matters raised in our prior year report either have been resolved or do not pose a material risk of error in the financial statements, and therefore have not been repeated in the current year report.

### **2. Condition – Preparation and Analysis Of Financial Statements:**

Even though ACF has made improvements in its financial statement preparation and analysis process, it must continue to improve on its processes to meet the more demanding reporting requirements in fiscal 2003. See Reportable Condition #1 in the current year Internal Control Report for further details.

### **3. Condition – Electronic Data Processing Controls:**

Even though ACF has rectified some of the matters identified in our prior year report, certain matters remain outstanding as described in Reportable Condition #2 in the current year Internal Control Report for further details.

### **4. Condition – Electronic Data Processing At ACF's Service Provider:**

The SAS 70 Report on Controls Placed in Operation and Tests of Operating Effectiveness for the Division of Financial Operations for the period October 1, 2001 to September 30, 2002 indicated that the matters identified in our prior year report were no longer applicable.

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Attached to this report are Management's Responses to the findings and recommendations summarized above. We have reviewed Management's Responses, considered their points and reevaluated our finding or recommendation. We have concluded that no change is needed to our original finding or recommendation. We will work closely with management to help them fully understand the key points of our recommendations.

In addition to the reportable conditions described above, we noted certain matters involving internal control and its operations that we reported to the management of ACF in a separate letter dated December 9, 2002.

This report is intended solely for the information and use of the management of ACF, HHS, the HHS Office of the Inspector General, OMB and Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Clifton Henderson L L P".

Calverton, Maryland  
December 9, 2002

**APPENDIX A**  
**DEPARTMENT OF HEALTH AND HUMAN SERVICES,**  
**ADMINISTRATION FOR CHILDREN AND FAMILIES**  
**MANAGEMENT RESPONSE TO AUDITOR'S**  
**INTERNAL CONTROL REPORT**  
**DECEMBER 9, 2002**

The following represents Management's Response to the Conditions and Recommendations included in the Independent Auditor's Report on Internal Control dated December 9, 2002, beginning on page 6 of this document. The specific Condition and Recommendation should be read in connection with the following Management Responses.

**INTERNAL CONTROLS**

**1. PREPARATION AND ANALYSIS OF FINANCIAL STATEMENTS:**

***Management Response:*** ACF concurs with the auditor's recommendation that ACF needs to expand its financial analysis throughout the year and make changes to the internal review process with respect to the financial statements. ACF contracts its financial statement preparation function and many of the related analysis functions to the Program Support Center (PSC). ACF has made substantial progress in the financial analysis of the Statement of Net Cost and is currently making plans to expand the analysis to more thoroughly review the Statement of Budgetary Resources and Statement of Financing.

- **Financial Statement Preparation and Analysis Can be Improved**

ACF will meet with its accounting services provider, PSC, to determine the steps necessary, if any, to more accurately and efficiently produce and review the Statement of Budgetary Resources and Statement of Financing and more timely implement new OMB format changes as they occur.

- **Review and Analysis of Budgetary and Net Position Accounts Needs Improvement**

ACF will meet with its accounting services provider, PSC, to determine the steps necessary, if any, to more accurately and efficiently produce and review the Statement of Budgetary Resources and Statement of Financing and more timely implement the new OMB format changes. ACF will review the propriety of mid-year adjustments to Net Position accounts on a more timely basis as suggested by the auditors. ACF will investigate the lack of a periodic reconciliation of Appropriated Capital Used and Expended Authority within its accounting services provider.



**APPENDIX A**  
**DEPARTMENT OF HEALTH AND HUMAN SERVICES,**  
**ADMINISTRATION FOR CHILDREN AND FAMILIES**  
**MANAGEMENT RESPONSE TO AUDITOR'S**  
**INTERNAL CONTROL REPORT**  
**DECEMBER 9, 2002**

- **FACTS II Preparation Process Needs To Be Linked to Financial Statement Preparation Process**

The initial FACTS II submission is made prior to the completion of the Financial Statement preparation process. This initial submission includes only financial data from the accounting system. Journal vouchers prepared to adjust the data from a cash basis to an accrual basis are not included in this initial submission. These adjustments are inputted at a later date when the financial statements have been finalized. The Program Support Center will investigate how to overcome this timing difference. This timing difference may be resolved through the use of the Unified Financial Management System (UFMS) that the Department of Health and Human Services is currently implementing. ACF is not scheduled to be fully migrated until FY 2007; therefore, an interim solution will be investigated.

- **Year-end Adjustments to Fund Balance w/Treasury (FBWT)**

ACF will make certain that unique programmatic regulations are communicated more effectively to its accounting services provider.

- **Grant Financial Analysis Needs Improvement**

ACF will seek assistance from within the Department to ascertain the proper methodology for the review of grant related accounts that are predominantly affected by the Departmental Regression Model. ACF currently does not have the resources to efficiently and effectively review the Regression Model nor can ACF independently explain differences between actual SF-272 data from the grantees and the grant accrual entry.

**2) ELECTRONIC DATA PROCESSING CONTROLS (GATES RELATED):**

**Management Response:** ACF concurs with the finding. ACF has, however, made significant progress in this area. ACF developed a draft System Security Plan and Contingency Plan for GATES as required by OMB Circular A-130, Appendix III. Based on these draft Plans, on July 15, 2002, following OMB and Departmental policy, ACF's Deputy Chief Information Officer officially granted "conditional approval and deferral of certification and accreditation" of GATES for one year. The "conditional approval" stipulated that a formal IT Security Certification and Accreditation (C&A) be conducted on GATES. ACF's Information Technology Security Unit (ITSU) is currently conducting the formal C&A, which includes performing a risk assessment of GATES, as well as updating, and testing of the GATES Contingency Plan.